Report

of the

Examination of

McMillan Warner Mutual Insurance Company

Marshfield, Wisconsin

As of December 31, 2004

TABLE OF CONTENTS

Page

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

December 16, 2004

Honorable Jorge Gomez
Secretary, Midwestern Zone, NAIC
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MCMILLAN WARNER MUTUAL INSURANCE COMPANY
Marshfield, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of McMillan Warner Mutual Insurance Company (the company) was conducted in 2000 as of December 31, 1999. The current examination covered the intervening period ending December 31, 2004, and included a review of such 2005 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

The company was organized as a town mutual insurance company on May 28, 1898, as McMillan Grange Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. On January 1, 2000, the company converted to a ch. 611, Wis. Stat., nonassessable mutual company. Substantially all of its articles and bylaws were revised as a result of the conversion. Since then there has been one amendment to the articles of incorporation and two amendments to the bylaws. The bylaws were amended in 2001 to establish the position of the Chief Executive Officer-General Manager and the duties and responsibilities of this position. However, in 2005 the bylaws were amended to delete the position of the Chief Executive Officer-General Manager. In addition, the articles of incorporation were amended to replace Victor A. Gray with Stephen Kaiser as the Registered Agent of the company.

Effective January 1, 2005, the company entered into a merger agreement with Lindina Town Mutual Insurance Company (Lindina). The surviving company was McMillan Warner Mutual Insurance Company. As a result of the merger, an "Advisory Committee" was formed made up of five former directors of Lindina Town Mutual Insurance Company. In addition, all property of Lindina become property of the company and a subsidiary was established, Lindina Insurance Agency (the agency). The merger increased the company's surplus position by $898,509 to $6,391,286. Further information regarding the agency is provided under the "Affiliated Companies" section of this report.

Wisconsin is the only state in which the company is currently licensed. The major products marketed by the company are homeowner and farmowner policies. The company also writes commercial multi-peril and umbrella business. The company's products are marketed through 207 independent agents operating out of 52 agencies.

The following table is a summary of the net insurance premiums written by the company in 2004. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Farmowner's multiple peril	$4,135,730	$0	$1,022,033	$3,113,697
Homeowner's multiple peril	1,421,121		351,191	1,069,930
Commercial multiple peril	114,038		28,182	85,856
Total All Lines	$5,670,889	$0	$1,401,406	$4,269,483

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. Three directors are elected annually to serve a three-year term. Officers are elected at the board's annual meeting. The board members currently receive $100 for a full day meeting, $60 for a half-day meeting and $15 an hour for other duties, as compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Keith Eibergen Granton, WI	Farmer	2006
Edward Hahn Mosinee, WI	Retired CPA	2007
Stephen Kaiser Auburndale, WI	Insurance Agency	2006
Merlin Kilty Abbotsford, WI	General Manager/Loss Adjuster of the company	2006
James Kolba Mauston, WI	Postal Worker	2008
Paul Mader Abbotsford, WI	Insurance Agent	2007
Jana Lee Marden Neillsville, WI	Retired Insurance Agent	2008
Roman Schaefer Jr. Marshfield, WI	Farmer	2008
Walter Wellhoefer Stratford, WI	Retired Farmer	2007

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2004 Compensation
Merlin Kilty	President/General Manager	$49,626
Stephen Kaiser	Vice President	2,086
Roman Schaefer Jr.	Treasurer/Secretary	3,440
Edward Hahn	2nd Vice President	2,295

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Adjusting and Executive Committee
Merlin Kilty, Chair
Stephen Kaiser
Roman Schaefer Jr.
Edward Hahn

Advertising Committee
Paula Mader, Chair
Keith Eibergen
Jana Lee Marden
Walter Wellhoefer

Audit Committee
Roman Shaefer Jr., Chair
Paul Mader
James Kolba
Keith Eibergen

Financial Committee
Merlin Kilty, Chair
Stephen Kaiser
Roman Schaefer Jr.
Edward Hahn
Walter Wellhoefer

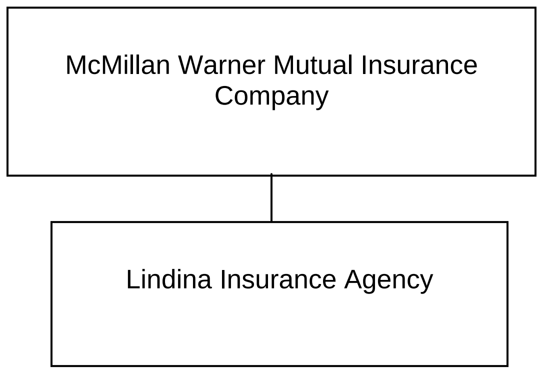
Manager Committee
Stephen Kaiser, Chair
Roman Schaefer Jr.
Edward Hahn
James Kolba

Nominating Committee
Roman Schaefer Jr., Chair
Jana Lee Marden
James Kolba

IV. AFFILIATED COMPANIES

Effective January 1, 2005, the company is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group.

Organizational Chart
As of December 31, 2004



Lindina Insurance Agency was formed on January 1, 2005, as a result of the merger agreement with Lindina Town Mutual Insurance Company. The agency services in-force business underwritten by Lindina Town Mutual Insurance Company in effect at the time of the merger and solicits new business for the company in the Juneau County area. The agency is managed by Chester Hawkins, the former manager of Lindina Town Mutual Insurance Company and a current employee of the company. As of December 31, 2005, the company reported the value of the agency as $1,000.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

1.	Type:	Property Per Risk Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Fire, Extended Coverage and Other Perils business
	Retention:	Part A: $150,000 per risk Part B: $300,000 per risk Part C: $1,000,000 per risk
	Coverage:	Part A: $150,000 excess of $150,000 per each and every loss, each and every risk Part B: $700,000 excess of $300,000 per each and every loss, each and every risk Part C: $2,000,000 excess of $1,000,000 per each and every loss, each and every risk
	Premium:	Part A and B: $1,350,000 or 23% of premium written, whichever is greater. Premium includes premium due for all of the following contracts: Property Per Risk Excess of Loss (Coverage A and B), Property Annual Aggregate Excess of Loss, Windstorm Occurrence Excess of Loss (Coverage A and B), and Liability (Coverage A and B). Rate stipulations for subsequent years are based on the combined ratio on business ceded to the reinsurer in the previous year(s): 2006 premium based on the <u>combined ratio in 2005:</u> 125%; premium rates increase by 2% 150%; premium rates increase by 3% 175%; premium rates increased by 4% 200%; prior to September 15 reinsurer retains the right to renegotiate or cancel this contract for 2006. 2007 premium based on the <u>combined ratio in combined 2005 and 2006:</u> 125%; premium rates increase 2% 150%; premium rates increased by 3% 175%; premium rates increase by 4% 200%; prior to September 15, the reinsurer retains the right to renegotiate or cancel this contract for 2007. Part C: $10,000 per year.

	Commissions:	Profit sharing: 10% of the profit of the reinsurer Profit is calculated as followed: All reinsurance premium earned by the reinsurer; less all amounts incurred by the reinsurer for loss and loss adjustment expenses; less all commission earned by the company; less the reinsurer's operating expenses equal to 20% of the reinsurance premiums
	Effective date:	January 1, 2005
	Termination:	January 1, 2008
2.	Type:	Property Annual Aggregate Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Property business
	Retention:	$2,900,000 or 65% of net premium, whichever is greater
	Coverage:	100% of the losses above the retention
	Premium:	See premium for Property per Risk Excess of Loss above
	Commissions:	10% of the profit, as calculated above
	Effective date:	January 1, 2005
	Termination:	January 1, 2008
3.	Type:	Windstorm Occurrence Excess of Loss
	Reinsurer:	Rockford Mutual Insurance Company
	Scope:	Windstorm and Hail business (excluding Fire, other Extended Coverage, and Other Perils)
	Retention:	Coverage A: $300,000 per occurrence which arises out of one atmospheric disturbance during a 72-hour period Coverage B: $1,000,000
	Coverage:	Coverage A: $95% of $700,000 excess of $300,000 per each and every occurrence Coverage B: 100% of $1,000,000 excess of $1,000,000 per each and every occurrence
	Premium:	See premium for Property per Risk Excess of Loss above
	Commissions:	10% of the profit, as calculated above
	Effective date:	January 1, 2005
	Termination:	January 1, 2008

4.	Type:	Liability Reinsurance Contract
	Reinsurer:	Rockford Mutual Reinsurance Company
	Scope:	Casualty business
	Retention:	Coverage A: $20,000 per any one occurrence Coverage B: Annual aggregate excess of loss of $200,000 or 20% of the preceding year surplus, whichever is lower
	Coverage:	Coverage A: Policy limit above $20,000 per any one occurrence Coverage B: 100% of net loss above the retention during one calendar year
	Premium:	See premium for Property per Risk Excess of Loss above
	Effective date:	January 1, 2005
	Termination:	January 1, 2008
5.	Type:	Umbrella Reinsurance Contract
	Reinsurer:	GE Reinsurance Corp 55% The TOA Reinsurance Company of America 30% QBE Re Company 15%
	Scope:	Personal and Farm Umbrella liability
	Retention:	5% quota share of the first $1,000,000 of ultimate net loss any one policy, any one loss
	Coverage:	95% quota share of the first $1,000,000 of ultimate net loss any one policy, any one loss
	Premium:	95% of gross net written premium for the first $1,000,000 limit
	Special acceptance:	Policies that exceed this limit of $1,000,000 may be submitted to the reinsurer for special acceptance Coverage: 100% of $4,000,000 excess of $1,000,000 Premium: 100% of gross net premium written for the amount of coverage greater than $1,000,000
	Commissions:	27.5% on annual gross net written premium
	Effective date:	January 1, 2005
	Termination:	December 31, 2005

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. An adjustment was made as a result of the examination and noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

McMillan Warner Mutual Insurance Company
Assets
As of December 31, 2004

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$4,141,838	$	$4,141,838
Stocks:			
Common stocks	1,470,655		1,470,655
Real estate:			
Occupied by the company	63,371		63,371
Cash	1,954,318		1,954,318
Short-term investments	404,534		404,534
Investment income due and accrued	58,772		58,772
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	10,242		10,242
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	1,002,372		1,002,372
Reinsurance:			
Amounts recoverable from reinsurers	14,178		14,178
Net deferred tax asset	84,000		84,000
Electronic data processing equipment and software	23,645	452	23,193
Furniture and equipment, including health care delivery assets	4,429	4,429	
Write-ins for other than invested assets:			
Contingent commissions receivable	57,387		57,387
Total Assets	$9,289,741	$4,881	$9,284,860

McMillan Warner Mutual Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2004

Losses		$ 384,732
Loss adjustment expenses		30,000
Commissions payable, contingent commissions, and other similar charges		345,926
Other expenses (excluding taxes, licenses, and fees)		40,023
Taxes, licenses, and fees (excluding federal and foreign income taxes)		24,949
Current federal and foreign income taxes		118,980
Unearned premiums		2,729,905
Advance premium		87,248
Ceded reinsurance premiums payable (net of ceding commissions)		30,320
Total liabilities		3,792,083
Unassigned funds (surplus)	$5,492,777	
Surplus as regards policyholders		5,492,777
Total Liabilities and Surplus		$9,284,860

McMillan Warner Mutual Insurance Company
Summary of Operations
For the Year 2004

Underwriting Income		
Premiums earned		$4,072,500
Deductions:		
Losses incurred	$1,643,918	
Loss expenses incurred	325,828	
Other underwriting expenses incurred	1,482,301	
Total underwriting deductions		3,452,047
Net underwriting gain or (loss)		620,453
Investment Income		
Net investment income earned	217,861	
Net realized capital gains or (losses)	19,617	
Net investment gain or (loss)		237,478
Other Income		
Write-ins for miscellaneous income:		
Billing fees	59,390	
Total other income		59,390
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		917,321
Federal and foreign income taxes incurred		289,951
Net Income		$ 627,370

McMillan Warner Mutual Insurance Company
Cash Flow
For the Year 2004

Premiums collected net of reinsurance			$4,165,680
Net investment income			221,402
Miscellaneous income			59,390
Total			4,446,472
Benefit- and loss-related payments		$1,256,663	
Federal and foreign income tax paid		226,871	
Commissions, expenses paid, and aggregate write-ins for deductions		1,764,856	
Total deductions			3,248,390
Net cash from operations			1,198,082
Proceeds from investments sold, matured, or repaid:			
Bonds	$595,144		
Stocks	155,447		
Total investment proceeds		750,591	
Cost of investments acquired (long-term only):			
Bonds	820,441		
Stocks	933,966		
Total investments acquired		1,754,407	
Net cash from investments			(1,003,816)
Cash from financing and miscellaneous sources:			
Other cash provided (applied)		19,603	
Net cash from financing and miscellaneous sources			19,603
Reconciliation			
Net change in cash and short-term investments			213,869
Cash and short-term investments, December 31, 2003			2,144,983
Cash and short-term investments, December 31, 2004			$2,358,852

McMillan Warner Mutual Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2004

Assets		$9,284,860
Less liabilities		3,792,083
Adjusted surplus		5,492,777
Annual premium:		
Lines other than accident and health	$4,269,483	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		2,000,000
Compulsory surplus excess (or deficit)		$3,492,777
Adjusted surplus (from above)		$5,492,777
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		2,800,000
Security surplus excess (or deficit)		$2,692,777

McMillan Warner Mutual Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2004

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2004	2003	2002	2001	2000
Surplus, beginning of year	$4,781,681	$4,330,247	$4,194,635	$3,913,466	$3,924,002
Net income	627,370	354,186	143,293	273,151	322,936
Net unrealized capital gains or (losses)	75,242	64,923	(64,249)	(36,459)	(136,754)
Change in net deferred income tax	4,753	23,106	55,705	33,525	
Change in nonadmitted assets	3,731	9,219	863	(9,088)	3,282
Cumulative effect of changes in accounting principles				20,040	
Aggregate write-in for gains and losses in surplus					
Prior period Adjustment					(200,000)
Surplus, end of year	$5,492,777	$4,781,681	$4,330,247	$4,194,635	$3,913,466

McMillan Warner Mutual Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2004

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	**2004**	**2003**	**2002**	**2001**	**2000**
#1	Gross Premium to Surplus	103.0%	109.0%	111.0%	90.0%	79.0%
#2	Net Premium to Surplus	78.0	82.0	88.0	76.0	72.0
#3	Change in Net Writings	9.0	3.0	19.0	13.0	36.0*
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	80.0	86.0	83.0	79.0	83.0
#6	Investment Yield	3.0*	3.4*	3.6*	3.9*	5.6
#7	Change in Surplus	14.0	11.0	7.0	9.0	1.0
#8	Liabilities to Liquid Assets	35.0	37.0	37.0	37.0	34.0
#9	Agents' Balances to Surplus	0.0	0.0	4.0	4.0	3.0
#10	One-Year Reserve Development to Surplus	3.0	2.0	1.0	-2.0	1.0
#11	Two-Year Reserve Development to Surplus	2.0	1.0	-2.0	0.0	0.0
#12	Estimated Current Reserve Deficiency to Surplus	1.0	-3.0	-2.0	2.0	-1.0

Ratio No. 3 reflects the percentage change in net premiums written from the prior year. The exceptional result in 2000 was due primarily to the company's conversion to a domestic mutual company, which allowed the company to expand its territory to all of Wisconsin.

Ratio No. 6 is net investment income earned as a percentage of the average amount of cash and invested assets during the year. The exceptional results in four of the five years under examination can be attributed to the fact that the company has a majority of its fixed income securities invested in certificates of deposits and tax-exempt bonds, which typically produce a lower investment yield and a generally low interest rate environment during the examination period.

Growth of McMillan Warner Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2004	$9,284,860	$3,792,083	$5,492,777	$627,370
2003	8,211,812	3,430,131	4,781,681	354,186
2002	7,338,202	3,007,955	4,330,247	143,293
2001	6,452,261	2,257,626	4,194,635	273,151
2000	5,885,732	1,972,266	3,913,466	322,936
1999	5,329,430	1,405,428	3,924,002	142,586

Year	Gross Premium Written	Net Premium Written	Net Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2004	$5,670,889	$4,269,483	$4,072,500	48.4%	33.3%	81.7%
2003	5,208,926	3,924,539	3,741,838	57.2	33.7	90.9
2002	4,823,187	3,801,401	3,341,935	63.2	30.7	93.9
2001	3,758,865	3,182,140	2,841,390	59.3	27.5	86.8
2000	3,092,883	2,817,192	2,444,562	63.9	26.6	90.5
1999	2,945,414	2,071,962	1,942,901	73.0	25.0	98.0

As indicated above, the company has reported favorable operating results for all the years under examination. Surplus has increased in all the years with the exception of 2000 [which was due to a prior year adjustment to surplus for $(200,000) for an advance payment that was not accounted for when computing the stop-loss attachment point]. Since the last examination, surplus has increased by 40% to $5,492,777, and gross and net premium written have increased by 93% and 106% to $5,670,889 and $4,269,483, respectively. The company's combined ratio has remained consistently below 100% for all the years. Management indicated that favorable operating results were due to the conversion to a domestic mutual company, rate increases, good underwriting, favorable loss experiences and investment income.

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination:

	Increase	Decrease	
Surplus December 31, 2004, per annual statement			$5,492,777
Losses	$	$80,000	
Net increase or (decrease)	$	$80,000	(80,000)
Surplus December 31, 2004, per examination			$5,412,777

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 12 specific recommendations in the previous examination report.

Recommendations contained in the last examination report and actions taken by the company are as follows:

1. Board of Directors—It is recommended that the company operate according to its articles and bylaws, or amend them to describe the intended assignment of officer duties.

   Action—Compliance.

2. Board of Directors—It is recommended that the company include detailed information on business discussions and decisions, regarding investments and lines of credit, in its minutes.

   Action—Compliance.

3. Reinsurance—It is recommended that the company comply with the stipulation and order and submit all reinsurance contracts for review by this office.

   Action—Noncompliance; see comments in the section of this report captioned "Summary of Current Examination Results."

4. Conflict of Interest—It is recommended that when a conflict of interest exists, the board member with the conflict should not vote on the issue, pursuant to s. 611.60 (2), Wis. Stat.

   Action—Compliance.

5. EDP Environment—It is recommended that the company retain its year-end reports for all years since the last OCI examination, pursuant to s. Ins 6.80, Wis. Adm. Code.

   Action—Compliance.

6. Disaster Recovery Plan—It is recommended that the company develop a written disaster recovery plan.

   Action—Compliance.

7. Invested Assets— It is recommended that the company complies with s. Ins 13.05, Wis. Adm. Code, which requires that access to a company safety deposit box containing negotiable securities shall require the presence and signature of two officers, directors or employees of the company.

   Action—Compliance.

8. Invested Assets—It is recommended that the company develop a written investment plan.

   Action—Compliance.

9. Cash and Invested Cash—It is recommended that the company obtain prenumbered check stocks and keep them secure until they are to be used.

   Action—Compliance.

10. Cash and Invested Cash—It is recommended that any check that is considered void should be clearly indicated on the face of the check.

    Action—Compliance.

11. Cash and Invested Cash—It is recommended that the company follow its policy and have two signatures on all checks over $10,000.

    Action—Compliance.

12. Cash and Invested Cash—It is recommended that the company put a stop payment on all checks that are voided and not in the possession of the company.

    Action—Compliance.

Summary of Current Examination Results

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

Board of Directors

The company obtained approval from this office every year since 2000 to permit the company's General Manager to issue the Statement of Actuarial Opinion; in 2004 this approval was also a permitted accounting practice because the NAIC annual statement instructions were changed to require an accredited actuary. In the review of board minutes for the period under examination and subsequent periods up to the date of the examination, the examiners noted that there were no formal discussions or recording of the board approval of the General Manager to be the appointed actuary in any year. From discussions with members of the board, the board was aware that the General Manager had acted as the appointed actuary, but there was no formal approval by the board of this appointment. It is recommended that the board formally approve and record the appointment of any appointed actuary.

Unclaimed Property

The review of the bank reconciliations revealed that the company has outstanding checks dated since 1998. Checks outstanding for more than five years are subject to the custody of the state as unclaimed property pursuant to ch. 117, Wis. Stat. The company indicated that it has not filed any unclaimed property reports to the state. It is recommended that the company comply with ch. 177, Wis. Stat., as regards to unclaimed property.

Reinsurance Contract

As a part of the company's conversion to a domestic mutual company, this office issued a stipulation and order on the company effective January 1, 2000. According to the stipulation and order, the company is required to send all changes made to its reinsurance contracts to the office for review. The prior examination recommended that contracts be submitted to the office pursuant to the stipulation and order. The current examination found that reinsurance contracts have changed in all the years under examination; however, reinsurance contracts for only two contract years have been supplied to the office for review. It is again recommended that the company comply with the stipulation and order and submit all reinsurance contracts for review by this office.

Reinsurance Intermediary

The company has its umbrella reinsurance contract placed through a reinsurance intermediary. In the review of reinsurance contracts, the examination noted that the company does not have a formal contract in place with its reinsurance intermediary. In accordance with s. Ins 47.03, Wis. Adm. Code, no reinsurance intermediary may represent the insured as a reinsurance intermediary unless the reinsurance intermediary obtains written authorization from the insurer, the reinsurance intermediary complies with the terms of the authorization, and the authorization specifies the responsibilities of each party. It is recommended that the company obtain a contract with its reinsurance intermediary in compliance with s. Ins 47.03, Wis. Adm. Code.

Loss Reserves **$464,732**

The examiners reviewed the reasonableness of the company's loss reserves by totaling actual loss payments made subsequent to December 31, 2004, for losses with incurred dates in 2004 and prior years. An incurred but not reported (IBNR) amount for 2004 and prior losses remaining unpaid at the examination date was added to the actual paid loss figure. The examiners' development of unpaid losses was compared with the amount estimated by the company. It was discovered the company had underestimated its loss and IBNR reserves by $36,288 and $25,429, respectively. In addition, the examiners noted that the company had some losses that were omitted from the open reserve file at year-end due to the claim being closed before year-end and then reopened in 2005. The company believes that these claims that were closed at year-end and reopened in 2005 may have been a clerical error. The total amount of these claims was $18,283. The total of the three adjustment items is $80,000. The above balance represents an increase of $80,000 from the balance reported by the company as of December 31, 2004. An adjustment is made as a result of the examination and this adjustment has been reflected in Section VI of this report under the heading, “Reconciliation of Surplus per Examination.”

Further review of the company’s Five-year Historical Data noted that the company has reported deficient loss reserve developments since 2002. Examination testing noted above concluded that the company has underestimated its loss and IBNR reserves. While the defiencies were a small percentage of prior-year surplus, they were a significant deficiency compared to the amount of the loss reserve established at the prior year-end. It is recommended that the company re-evaluate its loss and IBNR reserve methodology to adequately establish reserves for unpaid loss and IBNR at year-end.

Loss Adjustment Expenses

In the review of loss adjustment expenses, it was determined that the company does not properly categorize its expenses into Defense and Cost Containment and Adjusting and Other on Schedule P, pursuant to SSAP 55, paragraph 5(c), and the NAIC Annual Statement Instructions – Property/Casualty. Further review of the company’s claims system determined that the company has the capability to code its loss adjusting expenses into the proper category. It is recommended that the company categorize its loss adjustment expenses into Defense and Cost Containment or Adjusting and Other on Schedule P pursuant to SSAP 55, paragraph 5(c), and the NAIC Annual Statement Instructions – Property/Casualty.

Investment Policy

The examiners reviewed the company’s investment policy and noted that the policy requires a minimum collateral of 100% of the fair value of securities purchased under a repurchase agreement. Pursuant to SSAP No. 45, paragraph 8a, the fair value of the collateral under a repurchase agreement must be at 102% of the fair value of the security. It is recommended that the company change its investment policy on repurchase agreements and require a minimum of 102% of the fair value of securities purchased under repurchase agreement to be maintained as collateral in accordance with SSAP No. 45, paragraph 8a.

Fixed Assets

In the review of the company's depreciation method on fixed assets, it was determined that EDP equipment was depreciated using the straightline method over a useful life of five years. Pursuant to SSAP No. 79, paragraph 3, EDP equipment shall be depreciated over the lesser of its remaining useful life or three years. It is recommended that the company depreciate its EDP equipment pursuant to SSAP No. 79, paragraph 3.

VIII. CONCLUSION

The prior examination resulted in 12 recommendations. The company has complied with 11 of the 12 prior recommendations. The current examination resulted in 8 recommendations. The recommendations pertained to board minutes, reinsurance contracts, unclaimed property, loss reserves, loss adjustment expenses, investment policy and fixed assets. There was also one adjustment to surplus. Surplus was decreased by $80,000 due to the company underestimating its loss and IBNR reserves and additional payments made on claims closed at year-end 2004. As a result of the examination, surplus was decreased to $5,412,777.

Despite the adjustment to surplus, the company is well capitalized. For all the years under examination the company has reported positive net income. The company’s gross and net premium written had increased 93% and 106% to $5,670,889 and $4,269,483, respectively, due primarily to the expansion of its territory as a result of the conversion to a domestic mutual company and good underwriting. The company’s merger with Lindina Town Mutual Insurance Company effective January 1, 2005, increased the company’s surplus position by $898,509.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 23 - Board of Directors—It is recommended that the board formally approve and record the appointment of any appointed actuary.

2. Page 23 - Unclaimed Property—It is recommended that the company comply with ch. 177, Wis. Stat., as regards to unclaimed property.

3. Page 24 - Reinsurance Contracts—It is again recommended that the company comply with the stipulation and order and submit all reinsurance contracts for review by this office.

4. Page 24 - Reinsurance Intermediary—It is recommended that the company obtain a contract with its reinsurance intermediary in compliance with s. Ins 47.03, Wis. Adm. Code

5. Page 25 - Loss Reserves—It is recommended that the company re-evaluate its loss and IBNR reserve methodology to adequately establish reserves for unpaid loss and IBNR at year-end.

6. Page 25 - Loss Adjustment Expenses—It is recommended that the company categorize its loss adjustment expenses into Defense and Cost Containment or Adjusting and Other on Schedule P pursuant to SSAP 55, paragraph 5(c), and the NAIC Annual Statement Instructions – Property/Casualty.

7. Page 25 - Investment Policy—It is recommended that the company change its investment policy on repurchase agreements and require a minimum of 102% of the fair value of securities purchased under repurchase agreement to be maintained as collateral in accordance with SSAP No. 45, paragraph 8a.

8. Page 26 - Fixed Assets—It is recommended that the company depreciate EDP equipment pursuant to SSAP No. 79, paragraph 3.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Elena Vetrina	Financial Examiner

Respectfully submitted,

Sheur Yang
Examiner-in-Charge